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# Institutions, Economic Growth and Development: A Conversation with Nobel Laureate Douglass North

*Brian Snowdon*

## Key Points

- Douglass North, interviewed in this paper, died in 2015 and was one of the most influential economists/economic historians of the second half of the twentieth century.
- He was a pioneer of the application of economic data to investigate key issues in economic history, influencing the growing field of cliometrics.
- North recognised that cliometricians needed to modify neoclassical theory by incorporating into their analysis the influence of politics, institutions, transaction costs and property rights.
- He investigated the barriers to economic development and proposed the view that the formal rules of institutions are created, not necessarily to be socially efficient, but rather to serve the interests of those with the bargaining power to create new rules.

‘I set out to understand what makes economies rich or poor because I viewed that objective to being the essential prerequisite to improving their performance. The search for the Holy Grail of the ultimate source of economic performance has taken me on a long and certainly unanticipated journey from Marxism to cognitive science, but it has been this persistent objective that has directed and shaped my scholarly career.’

Douglass C. North (1997a).

‘Institutions are the rules of the game in a society, or more formally, are the humanly devised constraints that shape human interaction. In consequence they structure incentives in human exchange, whether political, social, or economic. Institutional change shapes the way societies evolve through time and hence is the key to understanding historical change.’

Douglass C. North (1990a).

## Introduction

Douglass North was one of the most influential economists/economic historians of the second half of the twentieth century and his influence will continue to inspire generations of scholars.<sup>1</sup> With his passing in November 2015, the fields of economics and economic history have lost one of their most productive and innovative minds. His teaching, multidisciplinary research, and numerous seminal publications have influenced generations of young scholars and contributed to the transformation of economics, economic history and the social sciences in general.<sup>2</sup> In recognition of his pioneering research and scholarship, in 1993 Professor North was awarded the Nobel Memorial Prize in Economic Sciences (jointly with Robert Fogel) ‘for having renewed research in economic history by applying economic theory and quantitative methods in order to explain economic and institutional change’.

Professor North’s long and distinguished career began modestly when he enrolled as an undergraduate student at the University of California, Berkeley in 1938. In 1942 he was awarded a BA in Politics, Philosophy and Economics and, following a wartime interruption of his studies, in 1946 he returned to Berkeley and completed a PhD degree in Economics, awarded in 1952.<sup>3</sup> Inspired by his desire to understand how economies function and his enjoyable experience as a graduate teaching fellow at Berkeley (1946–9), in 1950 North progressed to his first academic appointment at the University of Washington, Seattle. There he was successively Assistant Professor (1950–

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<sup>1</sup> Douglass North was born on 5 November 1920, in Cambridge, Massachusetts, and died on 23 November 2015 at his home in Benzonia, Michigan.

<sup>2</sup> See Myhrman and Weingast, 1994.

<sup>3</sup> During the period 1942–46, as a conscientious objector, he joined the US Merchant Marine and became a navigation instructor.

6), Associate Professor (1956–60) and Professor of Economics (1960–83). In 1983 Professor North moved to Washington University, St Louis, where he was based for the rest of his academic life. At St. Louis, Douglass North was appointed as the Henry R. Luce Professor of Law and Liberty and Professor of Economics and History. In 1996 he became the Spencer T. Olin Professor in Arts and Sciences.

During his career Professor North gave numerous invited lectures and keynote speeches at institutions and conferences worldwide. He has held many distinguished visiting academic positions, including those of Visiting Professor at Stanford University (1958, 1987–8), Rice University (1979) and Cambridge University (1981–2), of Research Associate at the National Bureau of Economic Research (1957–8), of Director of the National Bureau of Economic Research (NBER) (1967–8), and of Fellow and Senior Fellow at the Hoover Institution, Stanford University (1995–2015). From 1960 to 1966 he was co-editor of the *Journal of Economic History*, the flagship journal in the field of economic history. Professor North was the recipient of numerous honorary degrees and in 1987 was elected a Fellow of the American Academy of Arts and Sciences. In 1972–3 he was President of the Economic History Association and in 1991 received the John R. Commons Award from the International Honour Society in Economics. He also acted as a consultant to the World Bank, the Organisation for Economic Co-operation and Development (OECD) and to the governments of several countries, including China. In 1997 he was one of the co-founders of the International Society for New Institutional Economics.

In the following article I briefly review the major contributions made by Douglass North to both economics and economic history before presenting the text of a recorded interview that I conducted with him whilst attending the American Economic Association Annual Meeting held in New Orleans, USA, in January 2008.



## **Pioneer of the ‘New Economic History’**

Following a brief flirtation with Marxism at Berkeley, North underwent an intellectual conversion during his early years at the University of Washington. Under the influence of his colleague Don Gordon he gradually became a ‘gung-ho’ orthodox neoclassical economist in the tradition of the Chicago school.<sup>4</sup> In the early 1950s his first published work, building on his PhD thesis, focused on the life insurance industry.<sup>5</sup> However, by the mid-1950s North began to divert his attention to broader issues such as inter-regional economic growth in the US, the determination of ocean freight rates and the development of the American west (North, 1955, 1956, 1958a). By this time a group of American economic historians, including North, began to advocate the integration of economic history and economic theory. Their objective was to develop a more scientific approach to research in economic history. This involved utilising the tools of neoclassical economic theory and modern quantitative techniques to investigate key issues in economic history using the wealth of new data becoming available. An approach originally advocated by Eli Heckscher (1929), the ‘New Economic History’ (NEH) was a major challenge to the methodology of the ‘old’ economic history and in North’s view represented a genuine ‘revolution’ within the discipline.<sup>6</sup> Furthermore, as Brownlow (2010) observes, the ‘cliometric revolution’ was also an early example of the emerging ‘imperialist’ expansion of neoclassical economics into other fields of the social sciences, a development associated with the influence of Gary Becker (1993).<sup>7</sup> Economic history was viewed by the NEH as an application of neoclassical economics rather than a separate discipline: ‘cliometrics brought economic history into the discipline of economics’ (Goldin, 1995, p. 206).

Whereas the predominantly empirical methodology of the ‘old’ economic history relied on ‘complex and detailed description of past events’, including the extensive use of data and statistics as supporting evidence, the NEH

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<sup>4</sup> See Lyons et al., 2008, p. 199.

<sup>5</sup> E.g. North, 1953.

<sup>6</sup> See Lyons et al., 2008, p. 195. Hayek (1954) also advocated the need for more theoretical rigour in economic history research.

<sup>7</sup> Gary Becker was awarded the Nobel Prize in Economics in 1992 ‘for having extended the domain of microeconomic analysis to a wide range of human behaviour and interaction, including non-market behaviour’.

utilised modern quantitative techniques to test various hypotheses (North, 1977). As Goldin (1995) notes, '[t]he new economic history, or cliometrics, formalised economic history in a manner similar to the injection of mathematical models and statistics into the rest of economics'.<sup>8</sup> Therefore, the cliometric revolution represented a distinctive methodological shift within economic history from a prevailing inductive to a deductive approach, causing an 'uproar' among the traditional, old-school economic historians (Redlitch, 1965; Temin, 1973; McClelland, 1975; North, 1976). Indeed, by the mid-1960s, in a highly critical assessment of 'The state of economic history', North (1965) concluded 'that we need to sweep out of the door a good deal of the old economic history'.

Perhaps the best known and most controversial work to emerge within the NEH was the re-examination of the economics of slavery by Conrad and Meyer (1958) and Fogel and Engerman (1974); Fogel's (1962) counterfactual research on the 'social savings' of the American railroads; and North's work on the causes of the significant decline in the costs of ocean transportation, particularly in the nineteenth century. North's (1968) analysis showed how this decline was attributable to increases in total factor productivity. However, North also found that the decline in piracy and other organisational changes were significant factors enabling new vessel technology to be adopted. The superior ships, without need for heavy armament, together with a marked increase in round trips, significantly increased productivity. As Goldin (1995, p. 198) has emphasised, a major lesson from this contribution was that 'institutions interact with technology', and that 'one without the other does not produce economic growth'.

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<sup>8</sup> According to Williamson (1991) the use of the term 'cliometrics' was coined by Purdue University mathematical economist, Stan Reiter. However, Goldin (1995) suggests that it was Douglass North who first used this terminology.

## From the 'New' Economic History to the 'New' Institutional Economics

North's early publications focused on the US economy and increasingly on economic growth. In his two influential books on US growth (North, 1961, 1966), he continued to use the standard, neoclassical, theoretical framework of analysis, emphasising the importance of technological change. In 1966–7 he embarked on a Ford Fellowship year of study and teaching in Europe. This turned out to be a pivotal moment in North's intellectual development because in his attempts to understand European economic history he found the neoclassical model to be seriously flawed. North realised that the straitjacket of static, orthodox neoclassical theory was holding back progress in the NEH. Consequently, during the early 1970s North became heavily involved with the revival of institutional economics. In order to understand European economic history cliometricians would need to modify neoclassical theory by incorporating into their analysis the influence of politics, institutions, transaction costs and property rights (North, 1978).

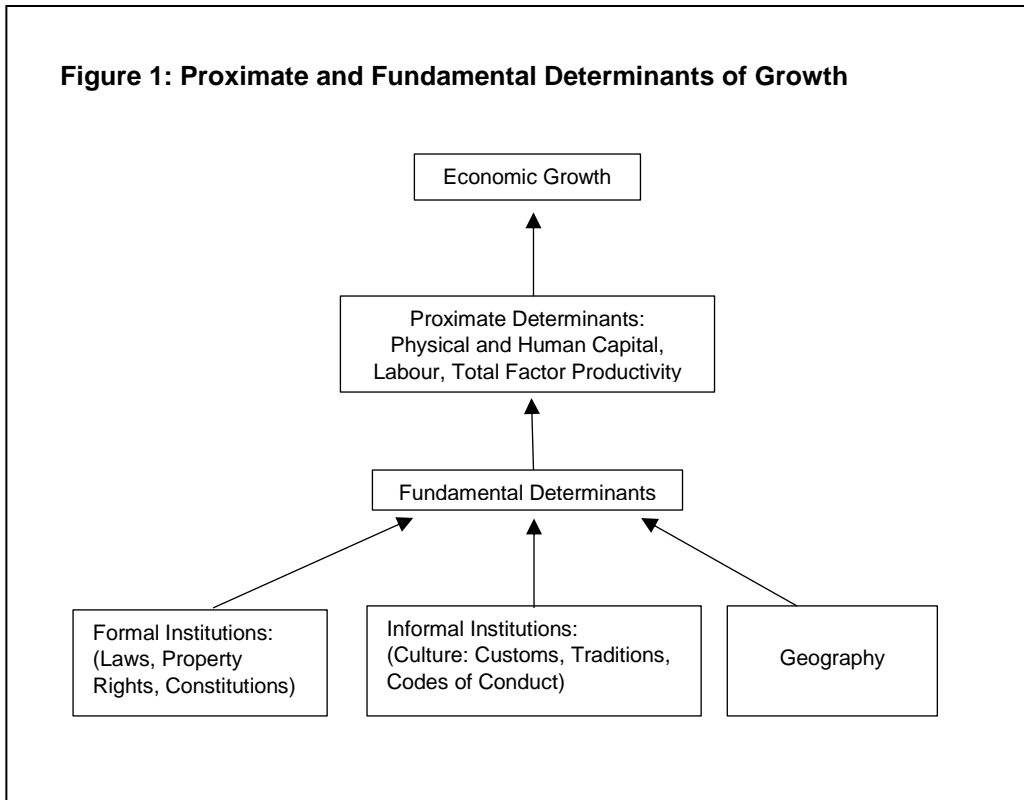
Arthur Lewis (1955, p. 11) was the first economist to explicitly distinguish between the *proximate* and the *fundamental* determinants of economic growth.<sup>9</sup> The proximate determinants include the contributions of capital accumulation (physical and human), increases in labour inputs and improvements in efficiency (total factor productivity)<sup>10</sup> (See Figure 1). The deeper or fundamental determinants include culture, geography and institutions. For North the primary task of economic history is to explain how and why economies change through time and during the last thirty years, inspired by his insights, economists have redirected their research focus in economic growth towards the role of institutions as the primary fundamental determinant of economic growth (Acemoglu et al., 2005; Acemoglu and Robinson, 2012). As North (1991a, p. 98) argues, '[t]he central issue of economic history and economic development is to account for the evolution of political and economic institutions that create an economic environment that induces increasing productivity'.

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<sup>9</sup> Arthur Lewis was awarded the Nobel Prize in Economics in 1979 (jointly with Theodore Schultz) for his 'pioneering research into economic development'.

<sup>10</sup> Snowdon, 2015.

**Figure 1: Proximate and Fundamental Determinants of Growth**



A major problem with orthodox neoclassical economics in a dynamic setting is that it takes as given many of the key explanatory factors such as preferences, property rights, institutions, population growth, technology and a functioning, non-corrupt state. But these are the very factors that economic historians need to analyse and explain! As North (1990a, p. vii) observes, ‘[h]istory matters. It matters not just because we learn from the past, but because the present and future are connected to the past by the continuity of society’s institutions. Integrating institutions into economic theory and economic history is an essential step in improving theory and history.’ However, orthodox neoclassical economics is ‘ahistorical’, founded on perfectly informed, rational, individualistic agents operating in an ergodic world without uncertainty.<sup>11</sup> It is this assumption that allows the ‘elegant

<sup>11</sup> An ergodic world is one where ‘the fundamental underlying structure of the economy is constant and therefore timeless’. A non-ergodic world is one of ‘pervasive uncertainty and continuous novel change’ (North, 2005, p. 16).

mathematical modelling that characterises formal economics'. But, as North (2005, p. 14) argues, it is the reality of uncertainty and a non-ergodic world that form the 'underlying condition responsible for the evolving structure of human organisation throughout history and pre-history'. Throughout history, institutions have been devised 'to create order and reduce uncertainty in exchange' (North, 1991a, p. 97). Consequently, for North a major task of economists and economic historians must be to explain the origin and impact of the 'historically derived constraints within which the human actor makes decisions' (North, 1977).

While it was Oliver Williamson (1975) who coined the term 'New Institutional Economics' (NIE), the foundations of the NIE can be found in the various contributions of several eminent economists including Nobel Laureates Kenneth Arrow, Gunnar Myrdal, Friedrich von Hayek, Herbert Simon and Douglass North (Klein, 1999; Williamson, 2000).<sup>12</sup> But the real significance of the neglect of economic institutions for economic theory came to light with a growing appreciation of the implications of Ronald Coase's (1937, 1960) work on transaction costs.<sup>13</sup>

Initially North adopted a neoclassical efficiency approach to explaining the emergence of institutions as a response to reducing transaction costs. In *The Rise of the Western World*, North and Thomas (1973) argue that institutions are the main determinant of economic growth but their analysis remains essentially neoclassical since more efficient institutions are seen to evolve in response to alterations in the structure of incentives caused by changes in relative prices. As North (1990a, p. 7) admits, this analysis is consistent with Alchian's (1950) evolutionary hypothesis, which suggests that 'ubiquitous competition would weed out inferior institutions and reward with survival those that better solve human problems'. In a neoclassical world of rational actors inefficient institutions will always be replaced with more efficient ones via a Darwinian selection mechanism!

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<sup>12</sup> The 'Old Institutional Economics' is the tradition of economics associated with economists such as Thorstein Veblen, Wesley Mitchell, Clarence Ayres, John R. Commons and John Kenneth Galbraith (see Rutherford, 2001).

<sup>13</sup> Ronald Coase was awarded the Nobel Prize in Economics in 1991 'for his discovery and clarification of the significance of transaction costs and property rights for the institutional structure and functioning of the economy'. See North, 1990a, 1991b.

For North the costs of transacting are a key factor in any explanation of the performance of economies. However, standard neoclassical economic theory examines the operation of markets working in a frictionless world of zero transaction costs. But transaction costs arise as soon as we move away from a single-agent, Robinson Crusoe-type economy and exchange between economic actors becomes the norm. In simple multi-agent economies, repeated personal exchange between well-informed individuals within a confined geographical space severely limits the opportunities for cheating and predation. In such economies, where production is often home-based, the limitations on specialisation give rise to low transaction costs but high production costs.

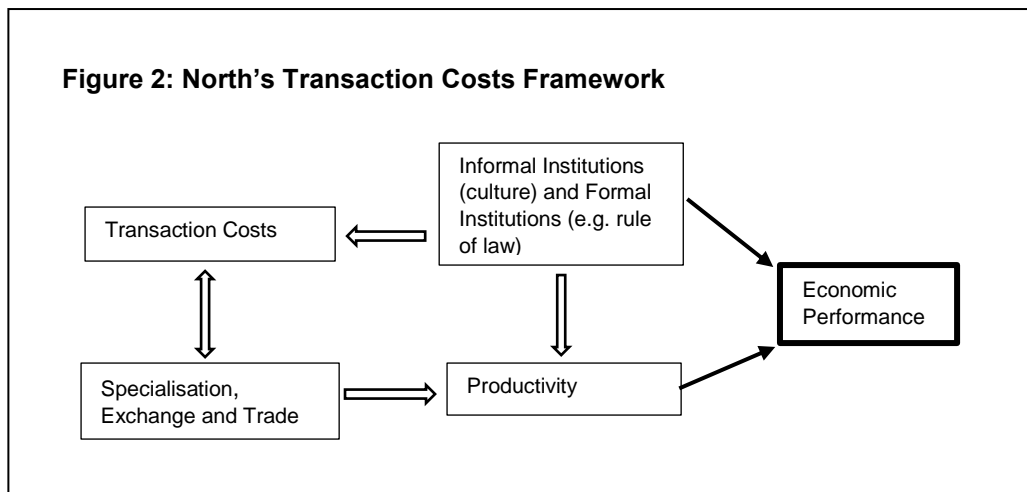
It was Adam Smith (1776), in *The Wealth of Nations*, who first emphasised the level and growth of productivity as the key to rising prosperity (North, 1984). Since productivity is mainly driven by specialisation and the division of labour, more complex economies increasingly require impersonal exchange between economic agents and organisations, often geographically far removed, and conducted over time.<sup>14</sup> This gives rise to significant transaction costs, defined by North (1994) as ‘the costs of specifying what is being exchanged and of enforcing the consequent agreements’.<sup>15</sup> Thus transaction costs include the costs of acquiring information, the costs of measuring the multiple dimensions of goods and services being traded, and the costs of monitoring, incentivising and enforcing the various contracts arising from impersonal exchange. Since contracts are invariably incomplete, the opportunity to cheat represents a constant threat to traders. While culturally determined, informal, institutions such as accepted ethical norms of behaviour, customs and taboos act as a constraint on opportunistic behaviour, formal institutional arrangements (‘rules of the game’) become increasingly necessary in complex economies in order to reduce the pervasive uncertainties arising from impersonal exchange and to realise the productivity gains from specialisation (see Figure 2).

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<sup>14</sup> North distinguishes between institutions and organisations. Institutions are the ‘rules of the game’ (formal and informal rules) whereas organisations (e.g. firms, trade unions, political parties, religious bodies, etc) are the players. See North, 1990a, 1994, 2005.

<sup>15</sup> Wallis and North (1986) estimate that the transactions sector (banking, law, accountancy, insurance and finance, etc) accounted for 45 per cent of US GNP in 1970.

The establishment and reliable enforcement of contracts and property rights requires ‘the development of a third party to exchanges, namely government’ (North, 1989). As North (2005) argues, ‘the key to improving economic performance is the deliberate effort of human beings to control their environment’, and the establishment of efficient institutions by lowering transaction costs (increasing property rights) reduces the uncertainty arising from impersonal exchange. Hence, free markets ‘do not in themselves mean efficient markets. Efficient markets require the establishment of an impartial third party of government to enforce property rights and contractual arrangements, and a set of attitudes towards contracting and trading that encourages people to engage in them at low cost’ (North, 1986, p. 236).<sup>16</sup>



In Williamson’s (2000) assessment of the NIE he concludes that North’s main contribution has been to bring into the analysis the important role played by formal and informal (culture) institutions. For example, in the book North co-authored with Lance Davis in 1971, *Institutional Change and American Economic Growth*, the authors show how economic growth depends on institutional innovation as much as factor accumulation and technological progress. In their analysis of economic growth in the Western

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<sup>16</sup> North (1990b) uses transaction cost analysis to show how political markets are much more inefficient than economic markets.

world, North and Thomas (1970, 1973) provide a bridge between the NEH and the NIE by attributing the fundamental institutional changes underlying the transformation of the Western world to changes in factor prices. This transformed the structure of incentives in favour of productivity-enhancing activities. However, by the early 1980s North's enthusiasm for the efficiency view of institutional formation and change had waned. With the publication of *Structure and Change in Economic History*, North (1981) had 'abandoned' the neoclassical efficiency view of institutional change. He began to entertain the idea that the various evolutionary selection mechanisms do not always ensure that institutional change has a positive reforming impact on an economy. The persistence of institutional inefficiency, leading to perverse social equilibria, is therefore a distinct possibility and requires explanation. This theme is developed further in his 1990 book, *Institutions, Institutional Change and Economic Performance* (North 1990a), in which he observes that '[t]hird world countries are poor because the institutional constraints define a set of payoffs to political/economic activity that do not encourage productive activity' (Menard and Shirley, 2011). By 1994, in his Nobel Lecture, North was fully committed to the view that '[i]nstitutions are not necessarily or even usually created to be socially efficient, rather they, or at least the formal rules, are created to serve the interests of those with the bargaining power to create new rules'. Clearly this observation has important implications for our understanding of the main political barriers to economic development and it was this issue that occupied North and his co-researchers during the last twenty years of his life.



## **Dysfunctional equilibria: from closed to open access societies**

The study of economic history is closely related to the field of development economics. In recent years Professor North devoted increasing attention to the relationship between economic and political institutions and the problems facing developing countries. In a series of papers and books he and his co-researchers have made an ambitious attempt to develop a coherent conceptual framework for analysing and interpreting recorded human history based on how human interaction is shaped by various collective attempts to deal with ‘the ubiquitous threat of violence’.<sup>17</sup>

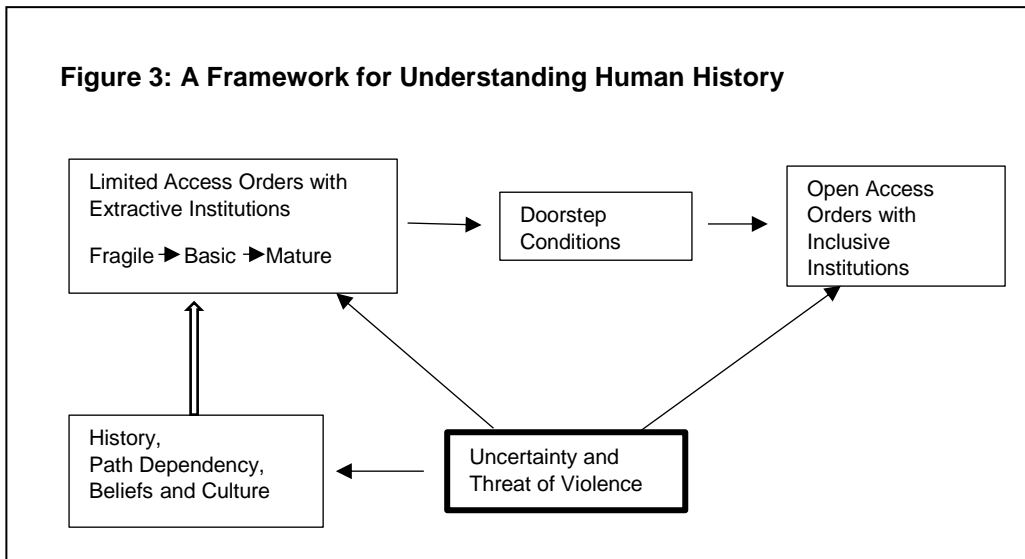
North et al. (2009a, p. 1) identify two major transformative revolutions and three social orders in recorded human history. The two revolutions ‘resulted in profound changes in the way societies were organised’. First came the neolithic or agricultural/urban revolution, beginning some ten thousand years ago (North and Thomas, 1977). The second revolution to transform the global economy was the Industrial Revolution, beginning in late-eighteenth-century Britain. The three social orders identified are:

- (1) the pre-neolithic revolution, primitive or hunter-gatherer foraging social order;
- (2) the limited access orders or ‘natural state’ following the neolithic revolution; and
- (3) the open access order after the Industrial Revolution.<sup>18</sup> The current world economy remains dominated by various forms of limited access orders (fragile, basic and mature) and a small minority (perhaps ‘two dozen’) of open access orders.

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<sup>17</sup> See North, Wallis and Weingast, 2006, 2009a, 2009b; North, Wallis, Webb and Weingast 2007, 2013, 2015; Cox, North and Weingast, 2015.

<sup>18</sup> This classification by type of social order is similar to Olson’s (1993) classification by political regime, namely, roving bandit regime, stationary bandit regime and democratic regime. Acemoglu and Robinson (2012) distinguish between societies with ‘extractive’ institutions and those with ‘inclusive’ institutions.



Limited access orders are characterised by the formation of a social equilibrium that attempts to control violence through elite privileges, limits access for non-elite groups to trade, provides ‘strong property right protection for elites’ and establishes a conducive environment for rent creation via ‘restrictions on entry into and exit from economic, political, religious, educational, and military organisations’ (North et al., 2006, p. 17). The establishment of elite privileges in closed access orders solves the problem of violence (at least in the short term), but does so by hampering sustainable long-term economic growth. In sharp contrast, open access orders are characterised by a competitive political and economic system, the rule of law, a free press and a democratically accountable government that has control of the military and the police, thereby exercising a monopoly on the control of violence (see Figure 3). Open access orders demonstrate ‘adaptive efficiency’ and are much better equipped to deal with the many new challenges that emerge as societies evolve through time. ‘Open access orders are therefore better than natural states at generating new ideas and at discarding bad ideas in the face of the omnipresent unfolding of new problems’ (North et al., 2009b, p. 63).

## Back to the future

Given the broad nature of his most recent work, it is evident that Professor North, in later life, had lost his early enthusiasm for a narrow neoclassical approach to the study of history and institutions. In so changing his work became more pluralistic, less deductive in terms of methodology, and increasingly heterodox in terms of content. For example, building on his 1994 Nobel Lecture, a major theme of his 2005 book *Understanding The Process of Economic Change* is how societies can get ‘stuck’ and be severely constrained in their attempts at reform by ‘inherited belief systems’. North emphasises the role of culture and how the persistence of beliefs can act as a severe impediment to successfully coping with ‘the endless novelty that humans confront as they evolve ever more complex and interdependent human environments’. For North (1994, p. 364) it is culture that ‘provides the key to path dependence’. Therefore, it is hardly surprising that the numerous attempts to export open access institutions and ‘Washington Consensus’ policies to closed access developing countries have met with such limited success.<sup>19</sup>

Some commentators have noted that the growing eclecticism demonstrated in Professor North’s recent body of research has much in common with the ‘old’ institutional economics and ‘old’ economic history (Hodgson, 1998, 2000; Rutherford, 2001; Brownlow, 2010). For example, the old institutional economics emphasised the influence of power relationships within society as well as culture, and the old economic history focused ‘primarily on the institutional structure and the change of that structure over time’ (North, 1977). Indeed the ‘pre-climetric economic history actually was built around institutions’ (North, 1990, p. 131). The broad ambition of North’s recent work is best captured in the following observation (North, et al 2009a, p. 1).

*“The task of social sciences is to explain the performance characteristics of societies through time, including the radical gap in human well-being between rich countries and poor as*

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<sup>19</sup> See Birdsall et al., 2010.

*well as the contrasting forms of political organisation, beliefs, and social structure that produce these variations in performance.”*

As Brownlow (2010) observes, this is very much in line with Kindleberger’s (1989) ‘historical economist’ approach to the conduct of research in economic history. For Kindleberger it is a mistake to ‘cling to a single or central theory’ and economic historians and economists ‘should be prepared to put down one economic law or model, and pick up another, when the condition to be explained calls for it’.

Perhaps North’s most important and enduring contribution has been to shift the focus in development economics away from a narrow emphasis on incremental change, induced by changes in the *proximate* determinants of factor inputs and technology, towards a perspective that highlights the complexities of dynamic institutional change. Consequently it is now commonplace for econometric research into economic growth to include institutional variables which frequently show a strong positive association with growth (Acemoglu et al., 2005).

When it comes to the big questions in economic growth and development North’s analysis incorporates elements from neoclassical theory together with the important, broader influences coming from politics, ideology, technology, demography and institutions. In particular North, Wallis and Weingast (2006, p. 72) describe the process of economic development as ‘the movement from a limited access order to an open access order’, a movement that in practice ‘is very difficult to engineer’. Thus the most exciting question in economic history and economic development remains: how do societies engineer a transition from a bad equilibrium to a good one? In seeking answers to this difficult question Douglass North’s reversion to eclectic historical economist in later life is clearly evident in his observation that ‘we must use all the tools of the social science theory that we can (not just economic), and we must apply them rigorously to confront the complexities of economic history’ (see Lyons et al., 2008).

## **An Interview with Douglass North**

### **Background information**

*Snowdon: Let's go right back to your early days at Berkeley in the 1930s. What attracted you into the field of economics?*

**North:** Well, I didn't start out with the intention of being an economist at all. As a Berkeley undergraduate I did a triple major in Philosophy, Political Science and Economics. I was actually a leader of the Marxist group at Berkeley and in those days I was going to save the world. But I never did get around to saving it (laughter). By the time the war came along I still didn't know what I wanted to do, but because I was averse to killing anyone and was a conscientious objector I joined the merchant marine. So I had three and a half years at sea to think about what I was going to do. By the end of the war, having travelled fifty thousand miles at ten knots, I still wanted to save the world and decided that the best way to do that was to become an economist. So I came back with the intention of going to graduate school. Unfortunately I only had a C average because I had spent my undergraduate years leading a left wing movement and organising peace marches. So the only place that would accept me was Berkeley, and they said that they would take me for one semester to see if I could improve, and I did.

*Snowdon: As a postgraduate student what did you study at Berkeley?*

**North:** I got my PhD in economics but during the graduate programme I have to admit that I had not really understood economics and memorised most of the analysis. So I actually knew very little mainstream economics when I graduated and took up my first academic appointment.

*Snowdon: You were a Marxist early on in your student life. At what point did you decide that Marx did not provide satisfactory answers to the questions you were interested in answering? I believe that you also became somewhat of an evangelist for neoclassical economics around this time.*

**North:** Oh yeah. Like so many former radicals I changed and became a good Chicago economist (laughter). About this time a job became available at the University of Washington in Seattle and it was there that I became a very good friend of Don Gordon who was an excellent neoclassical theorist. Every

day Don and I would play chess from noon until about two in the afternoon. I beat him at chess and he taught me neoclassical economics.

**Snowdon:** *At what point did you make the transition to specialising in economic history and economic development?*

**North:** At that time, around 1950, there was no recognised field of economic development. Indeed, economics was dominated by neoclassical price theory. What really interested me was the question of what determines differences in the wealth of nations, to borrow the title of Adam Smith's famous book. The closest I could get to studying economic development was to become a student of economic history.

### **Early influences**

**Snowdon:** *Who were the people who had an important influence on you during this formative part of your career, and to what extent did events also influence your thinking? For example, was your early attraction to Marxism a result of the catastrophic events arising out of the Great Depression and the resulting crisis of capitalism during the 1930s?*

**North:** At Berkeley I was influenced most of all by those economists on the left of the political spectrum who were very critical of orthodox neoclassical economics. People like Robert Brady, Leo Roglin and Melvin Knight. As a student, when I looked around me and read the existing social, economic and political theory, none of it seemed to address the kind of problems that were dominating the times, especially the Great Depression. Marxism seemed to be asking all the right questions. But, as I gradually began to find out, the answers were not very good. But at the time it seemed to be very attractive. Later on, people like Simon Kuznets and Walt Rostow influenced me.<sup>20</sup> I also found Joseph Schumpeter's emphasis on the need for economists to combine theoretical, statistical and historical analysis an important insight.<sup>21</sup>

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<sup>20</sup> Kuznets was awarded the Nobel Prize in Economics in 1971 'for his empirically founded interpretation of economic growth which has led to new and deepened insight into the economic and social structure and process of development'.

<sup>21</sup> See Schumpeter, 1954. 'What distinguishes the scientific economist from all the other people who think, talk and write about economic topics is a command of techniques that we class under three heads: history, statistics, and theory. The three together make up what we shall call Economic Analysis': p. 12.

**Snowdon:** *Did economic history attract you because it deals with the big issues relating to long-run growth and development?*

**North:** Yes, absolutely. I have always been interested in the big questions; in particular, why is it that some nations are incredibly rich while others are very poor? If you want to change the world you need to understand the process and dynamics of economic change. Neoclassical economics was not developed to deal with these grand issues. But to understand the dynamics of change requires a multidisciplinary approach involving knowledge from all the social sciences as well as an understanding of how societies learn. We need grand theorising to understand the rise and fall of nations.

**Snowdon:** *Do you see yourself as an economist interested in economic history, or an economic historian who is interested in economics?*

**North:** As a student I studied economics but in my academic career I began as an economic historian at the University of Washington. Now, at this point in my life, I see myself very much as multidisciplinary because my main interest is in trying to understand how societies evolve through time. This question is much broader than economics. The issues involved are complex and there are multiple causes interacting with each other. You cannot possibly make sense of the world unless you try and integrate political, social and economic theory. I also believe that you need to integrate cognitive science.

**Snowdon:** *I have interviewed several economists whose work on economic history is well known, for example Barry Eichengreen, Bradford DeLong, Ben Bernanke, Nick Crafts, Christina Romer, Jeffrey Williamson, Joel Mokyr and Claudia Goldin.<sup>22</sup> There are people who seem to feel comfortable working in Departments of Economics. Do you think it is important for economic historians to be located among economists?*

**North:** No, I don't think that is important. I think it is much more important for economic historians to work in a multidisciplinary environment. If you stick with economists and economics your perspective will become far too narrow and you will never find reasonable explanations for the big issues in economic history. The world we live in is one where political structure

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<sup>22</sup> See Snowdon, 2002, 2007a, 2007b, 2007c.

creates the economic rules of the game, and social structures dictate what you can and cannot do. So we, as economic historians, need to develop a body of theory that will allow us to investigate how *societies* evolve rather than just how *economies* evolve. Of course, it's true that economics must form a major part of any coherent explanation. But economics alone is not going to give us persuasive answers to the big questions.

### **The 'cliometric revolution' and economic history**

*Snowdon: What was it that ignited the new approach to economic history following the famous Williamstown conference in 1957?<sup>23</sup> Was it mainly that the 'old' economic history lacked rigour?*

**North:** Yes, it lacked rigour and also a body of coherent theory. Back in the 1950s much of the conventional wisdom about US economic history was inconsistent with standard neoclassical economic theory: for example, the conventional argument that antebellum slavery in the American South was unprofitable for plantation owners, and the overestimated impact of American railroads on US economic growth during the nineteenth century.<sup>24</sup> The cliometric approach enforced theoretical rigour and quantitative methodology on economic historians, both of which are important. It brought economic history into the field of economics.<sup>25</sup> Unfortunately the rigour, in terms of theory, turned out to be a blind alley for many of the big questions in economic history because the dominant economic theory is static neoclassical equilibrium theory. This is mainly concerned with how markets operate and function, and the optimal allocation of resources, rather than how markets evolve and develop. What you need, when exploring economic change, is a dynamic theory that incorporates human learning and an understanding of the evolution of belief systems, knowledge and cultures. Growth in the stock of knowledge is what acts as the main factor leading to change in the human environment.

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<sup>23</sup> See Lyons, Cain and Williamson (2008), for a discussion of this conference and all that followed. See also Conrad and Meyer, 1957.

<sup>24</sup> See Conrad and Meyer, 1958; Fogel, 1962.

<sup>25</sup> See Romer, 1994.



**Snowdon:** *Other than yourself, who were the key figures in the cliometric revolution?*

**North:** It all really began at Purdue in 1960. A number of people were influential, in particular Bill Parker and Bob Gallman. Simon Kuznets was a major influence: not only because he was developing quantitative data sets, he was also asking good, searching questions. Although not part of the New Economic History, Herbert Simon also had a major influence on my life. Not only was he a good friend, he also taught me so much about the limitations of the rationality postulate in neoclassical economics.<sup>26</sup>

**Snowdon:** *What about Walt Rostow? When I was an undergraduate in the late 1960s his work was still causing a lot of controversy among economic historians.*

**North:** Well, Rostow was already an established figure before the cliometric revolution took off, and had already developed his theory of societal change based on stages and the idea of a take-off into self-sustained growth.<sup>27</sup> But I didn't think Rostow had a very convincing theory. In fact my first entry into this fray was when I had a debate with Rostow, criticising his theory.<sup>28</sup>

**Snowdon:** *Early on, the Conrad and Meyer paper on slavery had a very important influence, as later did the famous Fogel and Engerman book, *Time on the Cross*.<sup>29</sup> Many non-economists saw these contributions as somehow justifying slavery, which of course was not the case at all.*

**North:** These contributions showed that slavery was profitable prior to the Civil War, and was not about to disintegrate as some previously thought. The Conrad and Meyer paper was a major breakthrough, not only in methodological terms, but also in terms of getting us all to rethink the economics of slavery. Their seminal paper came at the right time and had an enormous influence. Later on Fogel and Engerman caused an even bigger stir over the same issue. These contributions caused us to do some hard thinking about issues that we had never considered before.

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<sup>26</sup> Herbert Simon was awarded the Nobel Prize in Economics in 1978 'for his pioneering research into the decision-making process within economic organizations'.

<sup>27</sup> Rostow, 1956.

<sup>28</sup> See North, 1958b.

<sup>29</sup> See Conrad and Meyer, 1958; Fogel and Engerman, 1974.

**Snowdon:** *Your first book, The Economic Growth of the United States, 1790–1860, was published in 1961 and is regarded as one of the pioneering contributions to the New Economic History. This was a study of US economic growth for the period between the establishment of the US Constitution and the outbreak of the Civil War. That book was very influential because it emphasises the importance of inter-regional specialisation and trade for explaining US growth.*

**North:** Yes, and it was a very neoclassical approach that I took in that book. What made the US economy of that period susceptible to neoclassical theorising was that it was a large, relatively integrated market economy. So that book used neoclassical analysis in terms of inter-regional specialisation and inter-regional flows of trade to explain growth. I looked at how cotton production and exports in the South impacted on other sectors and regions of the US economy and how the spread of markets became an important foundation of economic growth.

**Snowdon:** *How well has the general thesis of that book stood the test of time?*

**North:** Well, the book is still in print so I guess it has passed the market test.

**Snowdon:** *Looking back at the cliometric revolution, what do you consider to have been the main achievements and deficiencies of the ‘new’ approach to economic history?*<sup>30</sup>

**North:** The key strength of cliometrics was to impose theoretical rigour on historical investigations. Economic historians began to place much more emphasis on obtaining quantitative measures of what they were doing. That was an enormous contribution. The main drawback was that the use of neoclassical theory became too much of a straitjacket on our thinking. Neoclassical theory simply cannot address the kind of questions that you must address if you want to progress our understanding of the causes of dynamic change. It turned out to be a blind alley on the really big questions in economic history. Economic history here in the US is still enormously influenced by the neoclassical paradigm. That’s OK providing you are concerned with issues amenable to the application of price theory. But if you

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<sup>30</sup> See Goldin, 1995; North, 1963, 1977, 1997b.

want to understand how societies evolve over time, as I do, it has little to offer.

**Snowdon:** *What is your view of the emergence of anthropometric research during the last few decades?*

**North:** I think it has been an important contribution because it deals with a neglected aspect of economic history, the influence of the environment on human physiology and the influence of physiology on productivity and economic growth. Bob Fogel has shown us that the vast majority of people before modern times could not work very hard because of poor nutrition, which meant that physically they were too weak to do so.<sup>31</sup> So demography is an important piece of the action. Institutions are another important influence, and standard price theory also has its place. So a good theory needs to combine these elements and at the same time get the dynamics right. When we can do that we might have a good theory of long-run development.

**Snowdon:** *During the last fifteen years or so there has been a welcome revival of interest in economic history. Many prominent macro-economists, previously obsessed with short-run business cycles, have turned to research questions relating to economic growth. Do you think the revival of interest in economic history is closely linked with the revival of interest in economic growth which began in the mid-1980s, and in particular the need to dig deeper to identify the fundamental determinants of growth?*

**North:** I think there is a strong connection. One way to try and understand the underlying causes of growth is to analyse what happened in the past, using our ever-increasing historical data set. This forces you to ask, and attempt to answer, a lot of very complex questions. The disadvantage is that the way that societies are now evolving may be different to the way societies evolved during the nineteenth and earlier centuries.

**Snowdon:** *How important to the revival of interest in economic history was the award of the Nobel Prize to Robert Fogel and yourself in 1993?*

**North:** When we were awarded the prize, Ronald Coase, an old friend of mine, wrote me a note saying that economic history was going to take off, and that we would revolutionise the discipline. We were a little disappointed

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<sup>31</sup> See Fogel, 1994, 2004; Floud et al., 2011. See also Steckel, 1998; Komlos and Snowdon, 2005.

because it did not seem to have such a dramatic impact on the discipline of economic history as Coase envisaged. It's certainly true that a few good people came along and made some very important and innovative contributions, but most people just kept on doing pretty much what they were already doing. I think that what you have just said about the revival of interest in economic history is not so much to do with Bob and I winning the Nobel Prize, but has more to do with the fact that in the modern world we are being forced to confront a lot of very fundamental problems. Uppermost is the question: why are there so many poor nations when we know so much about the major determinants of productivity and economic development? We know pretty much the key ingredients that characterise rich nations but we don't know how or how many of the poor nations can make the transition to sustained progress. Economists have been forced to look at economic history to see if it can throw up any clues.

**Snowdon:** *Who are the 'Young Turks' in the economic history field today? Avner Grief comes to mind.*

**North:** Avner is a very close friend of mine and he is an outstanding economist and economic historian. I think very highly of him, although for me he uses too much standard neoclassical game theory.<sup>32</sup> I just don't think that is the way to go. We need to develop a whole new body of theory to understand the process of change. Avner gets there by using equilibrium analysis, moving from one equilibrium to another. His work is imaginative and very creative, but I am not persuaded that this is the best route to follow. The major author of our forthcoming book is John Wallis of the University of Maryland, visiting Harvard this spring.<sup>33</sup> Right now I think John is the most promising, bright, economic historian in the field. John is running with the issues we have been discussing in a way that nobody else is doing.

**Snowdon:** *You have said that '[e]conomic history is a depressing tale of miscalculation leading to famine, starvation, defeat in warfare, death, economic stagnation and decline, and indeed the disappearance of entire civilisations'. You also say that 'throughout history we have gotten it wrong*

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<sup>32</sup> See Grief, 2006.

<sup>33</sup> North, Wallis and Weingast 2009a.

*much more often than we have gotten it right'.<sup>34</sup> Can you elaborate on these statements?*

**North:** Well, if you look back and read the recommendations that people believed would solve problems, so many turned out to be wrong, some catastrophically wrong. Think of the 'Great Leap Forward' and the 'Great Famine' in China in the 1950s and early 1960s that cost over thirty million lives, or the disasters of central planning. There have been some disastrous consequences around the world arising from believing in ideas that turned out to be nonsense. I am not a big optimist about our ability to identify clear solutions to the big problems that face us. But I firmly believe in having a flexible framework that allows you to adapt and respond quickly as new situations develop. We need a framework for policy that encourages trial and error and hope that eventually we get it right. That is the most important single recommendation that comes out of what we have been learning.

### **The 'New' Institutional Economics, economic history and development**

*Snowdon: At what point in your intellectual journey did the importance of institutions hit you? Were you influenced by Ronald Coase's work on transaction costs?<sup>35</sup>*

**North:** It was certainly Ronald Coase who first clearly saw the connection between neoclassical theory and institutions using the idea of transaction costs. But what really got me interested in institutions was when I decided to move my interest from American economic history to European economic history. I taught at the Sorbonne for one year, and lived in southern France and Geneva, Switzerland. This was in 1966–7. When I began looking at European economic history I found that there was no way of explaining European growth and development from medieval times onwards by using neoclassical economic theory. It was a dead end. You could make some sense of American economic growth using neoclassical economics because it was, early on, a market economy. But in European economic history you had to

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<sup>34</sup> North, 2005.

<sup>35</sup> See for example, North, 1984, 1986, 1990a, 1991a, 1994.

look at pre-capitalist systems such as serfdom and feudalism. This forced me to ask what was missing from our analysis. It soon became clear to me that the structure that dictates the kind of incentives that are crucially important for stimulating economic activity had to be the key ingredient. The outcome of this thinking was my 1971 book with Lance Davis, *Institutional Change and American Economic Growth*. This book was all about the importance of institutions. So was my 1973 book co-authored with Robert Thomas, *The Rise of the Western World*. However, at this stage both books were still influenced by neoclassical thinking because I was still assuming that the choice of institutions was mainly driven by efficiency considerations. In my later, 1981 book, *Structure and Change in Economic History*, I abandoned the idea that institutions were efficient and by 1990, in *Institutions, Institutional Change and Economic Performance*, I began seriously to question the rationality postulate.

**Snowdon:** *Coming from the North of England it is unsurprising that I should have a keen interest in the origins of the Industrial Revolution. Your 1989 paper with Barry Weingast had a tremendous and lasting influence. How much did the Industrial Revolution depend on that particular political development, the ‘Glorious Revolution’ of 1688?*

**North:** In that paper we looked in great detail at Britain during the Stuart monarchy and found that the events leading up to the Glorious Revolution had a profound effect in terms of changing the whole institutional framework in England. These days I would perhaps not claim as much as I used to about this idea, although Barry still likes that paper, and I believe that it is the most publicised paper in political science these days. I now think that we need to look at the whole sequence of events that led up to the Glorious Revolution rather than concentrating on that single event. In our most recent book on the evolution of open access orders we date the real development of such societies to the early nineteenth century, in England, France and the United States.

**Snowdon:** *Have you seen Gregory Clark’s new book, A Farewell To Alms?*<sup>36</sup>

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<sup>36</sup> Clark, 2007.

**North:** Yes. It is certainly causing a big stir because he argues that Malthusian pressures throughout history prevented society from breaking out of extreme poverty. I used a similar argument in my first book on Europe. But I no longer think that approach is the right answer. I am convinced that the answer has to lie in the social, political and economic organisation of society.

**Snowdon:** *General equilibrium theory is the magnum opus of neoclassical economics. Do you think economic history will ever have something equivalent to this in terms of a dynamic theory of long-run development?*

**North:** No, I don't think it will. Of course, that is what you would love to have, a framework that is based on a theory as powerful as general equilibrium theory in neoclassical economics. But the process of long-run growth and development is so complex, involving a multitude of interconnecting factors. I argue with economists about this all the time. Economists keep saying that we can develop useful models of growth, and they produce beautiful, elegant and internally consistent mathematical models. Do these models help us to understand a dynamic process such as economic growth over long periods of time? Not much. No single factor can explain economic growth because it is a very complex mixture of a variety of things going on, including social, political, demographic and institutional factors. It does not lend itself to establishing a simple framework that can be reduced to a few key equations. Neoclassical growth theory, old and new, is not very informative in explaining the historical experience of economic growth.

**Snowdon:** *You have frequently defined institutions as the 'rules of the game'. In your work, institutions are designed to reduce uncertainty in what is essentially a non-ergodic world.*

**North:** Uncertainty is where you do not have any idea of the probability distribution of outcomes. This is very much the way that Keynes viewed the world<sup>37</sup>. He gave great emphasis to the problems created for market economies by uncertainty. In a non-ergodic world of uncertainty it is very unlikely that there is some simple formula that you can use to successfully achieve transition to an open access society.

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<sup>37</sup> See Keynes, 1936, especially chapter 12.

**Snowdon:** *You have argued that ‘[f]or most interesting issues in political and economic markets, uncertainty, not risk, characterises choice making’. You have also made a distinction between two types of uncertainty, namely uncertainty that arises from the physical world, and uncertainty created by the human environment.<sup>38</sup> Can you elaborate on this?*

**North:** Well, in most poor countries agriculture is an important economic activity and there is always uncertainty relating to a possible deterioration in the geographical physical environment or the climate. Various investments can mitigate such physical-world uncertainty. But this still leaves you with uncertainty created by human actions.

### **Culture, geography and path dependency**

**Snowdon:** *Several economists and economic historians have recently turned their attention once more to the influence of culture on economic outcomes.<sup>39</sup> Your recent work has also emphasised the influence of culture on economic performance. How important is culture in explaining economic performance?*

**North:** Well, I define culture in a very specific way. Culture is the set of beliefs and institutions that you have inherited from the past that constrain the choice set in the present and the future. Beliefs evolve, survive and influence the choice of institutions because institutions are derived from beliefs. My definition does tie in with neoclassical economics in the sense that it is a theory of choice. But how do we arrive at the choice set that we have? This is where the importance of cognitive science comes in. Beliefs evolve differently because people have different experiences and backgrounds and therefore they see the world from different perspectives.

**Snowdon:** *Recently you have begun to do this, to incorporate ideas from cognitive science.<sup>40</sup> In doing so the line of inquiry keeps moving deeper. The performance of economies is affected by the quality of institutions. The formation of institutions reflects beliefs. But where do beliefs come from? In historical research we all invariably confront what I like to call the onion*

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<sup>38</sup> North, 2005.

<sup>39</sup> Guiso et al., 2006; Landes, 1998.

<sup>40</sup> Denzau and North, 1994; North, 2005.



*problem. That is, every time we manage to peel back a layer of history to see what causal factors are revealed, we find yet another layer that needs to be explained, then another layer and so on.*

**North:** Exactly, and that is part of the attraction of researching big questions. But I think we do have a good answer for that very important question: where do beliefs come from? First of all we should recognise that economics borrowed the whole approach to these issues from the physical sciences. In the physical sciences, if you wanted to solve a problem you could go back to the fundamentals, whether it be protons, neutrons or genes. But in economics all we have when trying to answer the question of where beliefs come from is how the brain works. So cognitive science is important and Hayek was fifty years ahead of everybody in recognising this back in the 1920s when he started to write about it when he was a student. These ideas were not published until much later in the 1950s, but nobody took any notice.<sup>41</sup> Hayek had terrific intuition. I have now been to a series of conferences with cognitive scientists and one of the frustrating things I have found is that they are very good at telling you how a worm's brain works, but have much less to offer when it comes to the working of the human brain (laughter). How does the human brain interpret what is going on around us, using information sent to it from our senses, hearing, sight, smell and touch? The brain has to interpret signals and make sense of them. To understand how the human brain does this is very complicated and the answers provided so far are very imperfect and incomplete. To get any further in answering the question on how beliefs evolve, we need to understand how the human brain interprets various signals.

**Snowdon:** *How do we decide how much of what has evolved is the result of cultural heritage and how much is down to genetic architecture?*

**North:** That is a big problem as you can imagine and is the source of great controversy. The evolutionary psychologists, who are a large influential group, argue that genetics holds the key.

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<sup>41</sup> See Hayek, 1952. Friedrich von Hayek was awarded the Nobel Prize in Economics, (jointly with Gunnar Myrdal) in 1974, for his 'pioneering work in the theory of money and economic fluctuations and penetrating analysis of the interdependence of economic, social and institutional phenomena'.

**Snowdon:** *How does your work relate to that coming from the group of evolutionary economists such as Geoff Hodgson?*<sup>42</sup>

**North:** There is a connection, but there is also a big stumbling block. Evolutionary theory says that we evolve and we don't really know what we are doing, but that the more efficient outcomes survive and progress. I believe that we need to consider the intentionality of human beings. We have in our brain ideas about what will and will not work. Most of these views turn out to be wrong. That translates into the way we evolve. The evolutionary economists ignore the intentionality of human action. We need to understand how people arrive at their beliefs about how the world works. What makes them hold onto these beliefs and what would lead them to change those beliefs. I want to get a handle on those issues but at the moment I do not have any good answers.

**Snowdon:** *You have also stressed the importance of learning when it comes to the choices that are made. But how do people learn?*

**North:** If we knew how people learn maybe we could change the direction of the way in which learning takes place. But obviously learning is a function of the existing belief system that defines what we think is learning. Learning is incremental and is inevitably influenced by a society's culture. All information received by an individual is filtered by their prior beliefs and experiences and is distorted by dogmas, myths and preconceived ideas. Non-rational beliefs can prevent or slow down necessary change. This is also part of the path-dependency story.

**Snowdon:** *How important is path dependency in your analysis of growth and development? For example, to understand economic development in South America you will not get far without looking at the impact of the Spanish colonial legacy. Daron Acemoglu, Stanley Engerman, Ken Sokoloff and other economists have looked at this.*<sup>43</sup>

**North:** This is why I defined culture the way I did. Every country is in some sense a prisoner of its own history, and culture is an important factor in path dependency. The past, present and future are all connected. The beliefs and institutions that you inherit from the past constrain the present choice set.

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<sup>42</sup> See, for example, Hodgson, 1999.

<sup>43</sup> Engerman and Sokoloff, 2000; Acemoglu et al., 2005; Acemoglu and Robinson, 2012.

You do not start from scratch but from the way you have evolved. Sometimes there are few choices due to constraints. Path dependency is a fact of history and changing the direction of a society for the better is very difficult. Some societies get stuck because their culture involves belief systems that are unable to deal with the new problems that emerge with the dynamics of change. The contrasting political and economic history of Latin America and the United States does provide a good example of how a historical divergence in institutional development has had powerful and long-lasting effects on the performance of these areas.<sup>44</sup>

**Snowdon:** *During the last decade Jeffrey Sachs has highlighted the neglect of geography by economists, especially when trying to explain the sub-Saharan growth tragedy.<sup>45</sup> How important is the influence of geography on economic growth and development?*

**North:** This is why you cannot have a general theory of economic development. There are so many important factors and geography is one. Obviously in the case of Africa, geography has severely constrained the way in which beliefs have evolved. For example, disadvantageous physical geography and climate in Africa have encouraged people to believe that being more productive is largely a matter of luck rather than good policies. This obviously can have a destructive impact on the choice of policies. If it's a matter of luck then redistributing income from the lucky to the unlucky becomes attractive.

**Snowdon:** *India has one billion people, is a democracy, has a unique cultural heritage and is now growing rapidly. On current trends it will have the largest population in the world in about thirty or so years. Are you optimistic about the future of India?*

**North:** Well, I have always resisted going to India to give advice because I think you need at least six months of research to try and understand the cultural and historical background of any country before you can even begin to think about policy issues. Cultural heritage will often play an important role in determining outcomes. So I don't know that much about India. Given that limitation it is clear that India now has a demographic advantage over

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<sup>44</sup> See North, 1989; North, Summerhill and Weingast, 2000.

<sup>45</sup> See Gallup, Sachs and Mellinger, 1999.

China, but the disadvantage of having evolved institutional interest groups that have until very recently throttled economic growth by imposing such anti-productive structures on society.

### **Interpreting history: limited access *versus* open access societies**

*Snowdon: In your current research with John Wallis and Barry Weingast you have been attempting to provide a ‘conceptual framework for interpreting recorded human history’, an ambitious project to say the least.<sup>46</sup> In that analysis you make a distinction between what you call ‘limited access orders’ and ‘open access orders’. First of all, what are the main characteristics of limited access societies?*

**North:** Limited access societies are those run by elites who make up a minority of the population, rarely more than about 15 per cent of the population. These elites run the system in their own interest. They may manage to get some growth in the economy, but they do so by limiting competition in both the political and economic spheres to protect their interests. These powerful elites can become very difficult to remove although the power structure within the elites may change. All the poor developing countries are limited access societies. So a set of social, political and economic elites run the system in their own interest. Systematic rent extraction and the exercise of market power is the name of the game and the political elites limit competition in the interests of the economic elites. Frequently these political and economic elites are made up of the same people.

*Snowdon: How does this contrast with open access orders?*

**North:** Open access orders or societies are characterised by open competition in both the economic and political spheres. Political and economic competition are complementary and help sustain each other. Open access orders also have a well-developed civil society. Markets and impersonal exchange can operate efficiently in open access orders. Unlike closed access orders the rule of law, in principle, operates in the interests of all members of society, not just the elite.

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<sup>46</sup> North, Wallis and Weingast, 2006.

**Snowdon:** *You identify three types of limited access society, namely, fragile, basic and mature, and you view economic development as a process whereby a society moves through these various stages before hopefully making the transition to becoming an open access society. But the last step is like crossing a void and has proved to be very difficult to achieve.*

**North:** Very difficult, and there is no general theory that can help us give advice. I am an economic advisor to many countries these days and I find that it is not possible to tell them how to make that crucial transition without first of all getting to know about the cultural background and heritage of that country. Without this knowledge you cannot know what their feasible range of choices is. Once you have that knowledge you can recommend incremental changes that will move them in the right direction, towards a more open access society. I am deeply involved with this and I visit China all the time to give my advice. Just last July, I was a guest of the Head of the Central Bank and he produced one of the most fascinating Round Table discussions that I have ever attended. He assembled all the economic advisors to the Chinese government and we spent two days asking each other questions. I bugged them and they bugged me (laughter). They were very conscious about the problems that China faces. There were no holds barred and I had freedom to say what I thought. I told them they were a communist dictatorship and the degree of political control was acting as a constraint on desirable economic change. In the privacy of the setting they agreed! They have 1.3 billion people, and in the space of a very short time they are trying to achieve a high level of development. The problems are just immense. The important point however is that trying to achieve a successful transition in China will require different ingredients than in Latin America, or sub-Saharan Africa. The way each country has evolved creates a set of present constraints, and these constraints differ across countries and continents. How these constraints can be overcome requires specific knowledge about the special circumstances, inherited from history, that each country faces. I have learned so much from my trips to China. It's fascinating to watch how they repeatedly cope with a variety of fundamental problems. These are sometimes geographic, sometimes institutional. There are big demographic issues now that the one child policy has rebounded on them. I was also an

advisor to Argentina in the 1980s and early 1990s. This was a completely different setting. This is why there is no general theory of development. It's not that we do not understand the main sources of productivity growth. We do, and that's a big plus. However, what will work in one context will not necessarily work in another. The simple-minded mathematical growth models of economists are of little help in the complexity of the real world.

**Snowdon:** *Only a few countries have successfully made the transition to becoming an open access society.*

**North:** Yes, mainly in Western Europe, North America and Australasia. But also Japan. Unfortunately Russia seems to be heading the other way.

**Snowdon:** *What importance do you put on the establishment of the US Constitution as a major factor that provided a stable political environment conducive to growth?*

**North:** It was very important because it provided a framework that allowed for political competition. As I said before, an open access society requires competition to be established in both the political and economic spheres.

**Snowdon:** *Does this mean that the whole Washington Consensus idea of transferring policy recommendations to closed access developing countries, such as promoting privatisation, competition and openness to trade, is likely to produce disappointing outcomes?*<sup>47</sup>

**North:** They can produce chaos. If the policies that work in an open access society are used in limited access societies they will undermine the existing structures that the elites have created that are maintaining order, as well as their privileged position. Policies designed to improve economic efficiency may well lead to big problems in developing economies if their consequences are seen by elite groups as a threat to their dominance. Given the persistent threat of violence and disorder that exists in the world, the introduction of competition into limited access societies undermines prevailing power structures that have been created to preserve order. Once you undermine the status quo there is no guarantee that the new situation will be an improvement. This is why the Iraq story is such an important lesson. You can see the same kind of problem all over the world. It's a very difficult point to

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<sup>47</sup> See Birdsall et al., 2010.

swallow but you do not want to undermine authoritarian regimes that are a source of order, at least not in the short run. Of course you want to encourage the kind of incremental changes that will encourage progress in the longer run, so that these countries can become more open and democratic.

**Snowdon:** *So in the debate on shock therapy versus gradualism that dominated discussions about how to successfully engineer a transition from communism to capitalism, clearly you would be on the side of the gradualists such as Janos Kornai.*<sup>48</sup>

**North:** Yes. Shock therapy is a recipe for disorder.

**Snowdon:** *Milton Friedman always argued that economic freedom is a necessary prerequisite for political freedom, though not a sufficient condition. Janos Kornai argues the same point.*<sup>49</sup> *The connection between democracy and economic freedom is a complex one and in relation to this issue you have introduced the concept of ‘double balance’. How does this concept relate to these open access societies?*

**North:** The relationship is far from simple and is likely to vary across countries. But essentially, down the road, you have got to have competition in the economic and political spheres to become an open access society. The reason why is that if you only have competition in one of them, then there will be monopoly power in the other, leading to rent seeking, which throttles development. By double balance I mean that an open competitive economy reinforces an open access political system and an open access political system supports an open entry economic system. A competitive liberal democracy can only survive if there is also competition in the economic sphere. This is one of the predictions of our theory.

**Snowdon:** *You have emphasised the need for societies to foster ‘adaptive efficiency’.*<sup>50</sup> *Successful societies are those that are not only efficient, but are also flexible and innovative. They can successfully manage creative destruction.*

**North:** This goes back to our discussion of living in a non-ergodic world. In such a world you cannot know with any certainty the answers to many

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<sup>48</sup> See Snowdon, 2007a.

<sup>49</sup> Friedman, 1962; Kornai, 2000.

<sup>50</sup> North, 1999, 2005.

problems. You might find a solution but this is usually through a process of trial and error. This requires an institutional framework that allows flexible approaches to problems, that allows trial and error. If errors survive because of interest group pressures, even when you know there is a better way, then this will be a disaster. Adaptive efficiency means both encouraging trials and experimentation in order to limit errors. Open access orders allow a free flow of new ideas and a range of solutions to problems. There is competition which promotes solutions to new problems as they emerge. This is what you need to solve the vast array of new problems and shocks that are constantly emerging in all societies. Limited access societies tend to restrict new ideas and solutions and hence lack flexibility. Open access societies are more prepared for creative destruction and to discard ideas which have failed to solve the key problems.

**Snowdon:** *In your theory of the evolution of social orders you talk about the importance of ‘doorstep conditions’. Once these are in place a society has a chance to make the transition towards becoming an open access society. Which doorstep conditions would you highlight?*

**North:** In our new book we focus on three important doorstep conditions. First, the extension of secure property rights to society in general rather than just the elite group. Elites always protect their own property rights, but progress requires that these rights are extended to the masses. The second condition is the need to develop organisations and institutions that have a broader range of interests and survivability than they do in a limited access society. The third doorstep condition is that you must have civilian control of the military. This is crucial because if the military can independently decide things, which they can in many parts of the world, including China, then you will never achieve a sustainable open access society.

**Snowdon:** *Jeffrey Sachs advocates a significant increase in foreign aid as a key ingredient for helping many sub-Saharan developing countries to escape from their ‘poverty trap’.<sup>51</sup> You are much less enthusiastic. Why the pessimism?*

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<sup>51</sup> Sachs, 2005.



**North:** Foreign aid does not necessarily have to fail, but it has to be consistent with the whole story that we tell about limited access societies moving from fragile to basic to mature. In a fragile limited access society aid inflows can very well be destabilising. In mature limited access societies there may be more leeway for foreign aid to be successful.

**Snowdon:** *What impact does globalisation have on the development prospects of limited access societies?*

**North:** It's a mixed bag. On the one hand it has pretty much the effect that economists say it will have on competition, trade and productivity. On the other hand, it is likely to destabilise the privileged position of elites thereby generating instability, violence and chaos. There are clear benefits as well as clear risks and costs. What you would ideally like is for globalisation to be taking place in ways that do not generate the downside impact. But we do not know how to do that. So there is nothing the matter with the prescription for more international integration providing it is put into a proper context.

**Snowdon:** *Do you think that social scientists will ever find a satisfactory explanation of the origins and causes of economic growth and development? Is it not a frustrating experience trying to answer such big questions?*

**North:** Yes, but it is also very stimulating. In our latest book we think we have put together a coherent and convincing story. We provide a whole new approach to economic development that has revolutionary implications for development theory. We argue that the policies that we know make open access societies more efficient, when transferred to poor countries may not work and can produce the opposite of what is intended. We often see destabilisation, violence and chaos. The World Bank is very interested in what we are doing. Of course we began this line of thought before the disastrous intervention in Iraq provided a tragic example of the very argument that we are making. When you destroy or dismantle, even what is a vicious dictatorship, the outcome can turn out very different from what you might expect. You cannot change a whole social and political system overnight. So our new book is about how you create a whole new social order that is based on very different principles, and how you can try to get there.

**Snowdon:** *In Ben Friedman's (2005) book, *The Moral Consequences of Growth*, he highlights the fact that in a growing economy there is likely to be*

*much less conflict. In a static, zero-sum world various forms of conflict are almost certain to occur. Yesterday, at the AEA Conference, Nick Stern gave a paper on global warming and it struck me that if at some point economic growth must slow down, then the potential for conflict will increase.<sup>52</sup> Are you optimistic about the twenty-first century given this looming problem, assuming that it is caused or made worse by human economic activity?*

**North:** I am not a big optimist on this. But it's a non-ergodic world so neither I nor anybody else can forecast what is going to happen, including whether global warming is going to produce the havoc that some people believe. I am not yet convinced that it will produce the havoc that the extreme pessimists predict. At the Copenhagen Consensus we got a lot of flak for not putting this problem at the top of our agenda<sup>53</sup>. But I do not have an answer to this kind of question because there is too much uncertainty. If I was President of the United States, or any other country, I do think that I would be taking precautionary measures just in case. I don't think that we should do nothing and hope for the best. So I see nothing wrong with introducing measures to reduce carbon emissions around the world and I don't mind limiting growth to achieve that. So being risk-averse I advocate a cautious approach.

## **Future research**

***Snowdon:** What are your plans for future research?*

**North:** Our latest book, more than any book that I have ever done, has raised enough issues to keep me working for the rest of my life.<sup>54</sup> There are many things that we have yet to explain. We don't explain the transition completely. We don't explain in a satisfactory way how political systems evolve and how you get adaptive efficiency. We have raised more questions than we have answered, so I guess I better keep working.

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<sup>52</sup> Stern, 2008.

<sup>53</sup> 'The Copenhagen Consensus is a think tank 'that researches and publishes the solutions to the world's biggest problems'.

<sup>54</sup> North et al., 2009a.

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